Opinion of Court of Appeals

United States Court of Appeals for the Second Circuit

October Term, 1954

No. 261

Argued March 18, 1955. Decided April 14, 1955.

Docket No. 23557

General Stores Corporation, Debtor-Appellant

v.

Max Shlensky and Securities and Exchange Commission, Appellees

Before Clark, Chief Judge, Frank, Circuit Judge, and Galston, District Judge.

Appeal from the United States District Court for the Southern District of New York, Edward J. Dimock, Judge.

General Stores Corporation appeals from an order dismissing its petition under Chapter XI of the Bankruptcy Act unless it files an amended petition under Chapter X of the same act. Affirmed.

Melvin Liebowitz, New York City (Aaron Rosen, Frederic P. Houston, and Otterbourg, Steindler, Houston & Rosen, New York City, on the brief), for debtor-appellant.

A. Alan Reich, New York City (Reich, Peller, Guadagno & Caine and Howard Sog Shugerman, New York City, on the brief), for appellee Max Shlensky.

William H. Timbers, Gen. Counsel, Securities and Exchange Commission, Washington, D. C. (David Ferber, Spec. Counsel, and Richard V. Bandler and Ezra Weiss, Attys., Securities and Exchange Commission, Washington,

D. C. on the brief), for appellee Securities and Exchange Commission.

Max Goldweber, Jamaica, N. Y. (L. J. Weinshenker and Weinshenker & Kenner, New York City, on the brief), for Wage Claimants.

Leon Singer, New York City (Samuel Blumberg and Blumberg, Singer, Heppen & Blumenthal, New York City, on the brief), for Creditors of General Stores Corporation.

CLARK, Chief Judge: The debtor, General Stores Corporation, filed a petition under Chapter XI of the Bankruptcy Act, 11 U. S. C. Sec. 722, for an arrangement of the debts owed to its unsecured creditors. According to its plan these creditors were to receive the full face amount of their claims over a five-year period. Max Shlensky, a stockholder, challenged the adequacy of the Chapter XI procedure through a show cause order seeking a transfer to Chapter X pursuant to the newly enacted 11 U. S. C. § 728. The Securities and Exchange Commission, being granted leave to intervene, filed a motion to similar effect. Judge Dimock granted this motion and ordered the present petition dismissed unless the debtor within forty days filed an amended petition complying with the requirements of Chapter X. We stayed this order pending our determination of the debtor corporation's appeal. On this appeal the order below is supported by the stockholder and the SEC, while reversal is sought by the debtor and representatives of the general and wage creditors.

The present corporate structure of the debtor corporation is not overly complicated. General Stores Corporation is, however, the corporation formerly known as D. A. Schulte, Inc., whose somewhat checkered financial history is referred to below. At the present time there are two main corporate assets, the cash received from liquidation of the Schulte tobacco stores which were formerly the chief source of income, and stock of two wholly-owned subsidiaries, Stineway Drug Company and Ford Hopkins Company. These assets total about $5,000,000. On the

other side of the ledger there are about $4,000,000 of liabilities and a capital account of more than $2,000,000. Half of the liabilities are the unsecured debts here sought to be settled by arrangement. The other liabilities represent the unpaid purchase price of the subsidiary corporations in which the debtor has just recently invested, and these liabilities are secured by the stock of the subsidiaries. The capital account consists of 2,322,422 outstanding shares of $1 par common stock, held by 7,000 stockholders and traded on the American Stock Exchange.

As D. A. Schulte, Inc., General Stores went through a § 77B reorganization from 1938 to 1940, in which much of the old common stock turned out to be worthless. Now the new common is again partially under water, and the stockholders are justifiably concerned, for their interests are in no way protected in a Chapter XI proceeding. They fear that the change from Schulte type stores to regular drugstores may only postpone the liquidation or reorganization which may be inevitable; and they wish some assurance of a fair plan now, before the remaining assets are dissipated.

We concur in Judge Dimock's well reasoned opinion that this situation calls for the greater investigation and protection of Chapter X rather than for the informal arrangement of Chapter XI. His decision, we think, makes an appropriate evaluation and analysis of the criteria set out in *Mecca Temple of Ancient Arabic Order of Nobles of Mystic Shrine* v. *Darrock*, 2 Cir., 142 F. 2d 869, certiorari denied 323 U. S. 784, which a majority of this panel think were rather slighted in the more recent decision of *In re Transvision, Inc.*, 2 Cir., 217 F. 2d 243, certiorari denied Feb. 28, 1955, though, as Judge Dimock points out and we discuss below, this case differs markedly from *In re Transvision, Inc., supra.* In our view a widespread stockholder interest in a corporation with such a shaky financial history as this one is in itself sufficient ground for the invocation of Chapter X proceedings. Even the unsecured

creditors who are urging the reinstatement of the Chapter XI petition may come to regret their decision during the interval of postponed payment, without interest, of their claims. For the present proceedings are completely in the control of the debtor corporation on whose financial acumen and bookkeeping accuracy must rest the fairness and the feasibility of the proposed arrangement. Too great a public interest is here at stake to allow the present management of the debtor to secure court ratification of such a plan without having available to all parties the disinterested appraisal and judgment of the Securities and Exchange Commission. It is noteworthy that a corporation of this size is one for which SEC intervention is mandatory in a Chapter X proceeding. Bankruptcy Act § 172, 11 U. S. C. § 572.

Hence this is emphatically not the small corporation in which the calculated risk of the informal Chapter XI proceedings is warranted. It does not fall into the category of tightly knit structures where the subordinate creditors and stockholders are the management of the business and where the preservation of going concern value through their continued management of the business may compensate for reduction of creditor claims without alteration of management interests. *Securities and Exchange Commission* v. *U. S. Realty & Improvement Co.*, 310 U. S. 434, 454. The criteria for choice between Chapter XI and Chapter X enunciated in that case were written into the Bankruptcy Act by the enactment of § 328, 11 U. S. C. § 728, in 1952. See 1952 U. S. Code Cong. & Adm. News 1979-1980. We are content to apply them here.

The contrast between General Stores Corporation, a multimillion dollar corporation with 7,000 stockholders whose stock is actively traded on a leading stock exchange of the country, and *In re Transvision, Inc., supra*, 2 Cir., 217 F. 2d 243, 246, 247, is well pointed up by Judge Dimock, who says: "In the Transvision case the debtor had outstanding 385,000 shares of common stock and 1773½ shares of preferred. All were in the hands of management in-

terests, except 135,000 shares of common held by 425 investors. It was not listed on any exchange. The debtor's liabilities were about $700,000 and its assets about $1,000,000." So in that case Judge Sugarman exercised his discretion in denying transfer to Chapter X—a factor emphasized in the *U. S. Realty* case, *supra*, 310 U. S. 434, 455-457—and our brothers sustained him. The inference seems clear to us that upon their reasoning they would have sustained Judge Dimock's reasoned exercise of discretion here. We are bound to add, however, that their stress upon such criteria as the proposal of "relatively simple plans" or a "reasonable likelihood that the desired financial recovery will be effected without unduly prejudicing the rights of any interested parties" and their suggestion that a later showing of "irregularities of management" may then lead to an order of transfer do not seem to us realistic or operable in the premises. Rather, following the *U. S. Realty* and *Mecca Temple* cases, the court must evaluate the sufficiency of the remedy for the apparent need and must do so, in order to afford any protection at all adequate, at the beginning of the proceedings and before committing steps of a contrary nature have been taken. This is the course which was taken below. Its order must therefore stand; except of course for the setting of a new date within which the debtor or its creditors may file an amended petition under Chapter X if they so choose. Our stay will remain in effect until the district court acts.

Order affirmed; action remanded.

FRANK, Circuit Judge, concurring:

I agree with all that Judge Clark says. However, while he may well not have intended to go beyond severely restricting the recent decision of this court in In re Transvision, Inc., 217 F. (2d) 243 (C. A. 3), his opinion may perhaps be read as intending to over-rule it. I think it desirable, therefore, to say that I am not ready to go that far,

although, had I been sitting in the panel which decided that case, I would have dissented. I would say here merely that I think the rationale of the Transvision decision should be limited to a case where the facts are in most respects similar, i. e., a case where (a) but a relatively small proportion of the securities is publicly held by a small number of investors, (b) none of the securities was listed on any exchange, (c) the assets do not exceed approximately $1,000,000, and (d) there are merely the faintest suspicions raising questions about the conduct of the management.

GALSTON, District Judge (dissenting)

I do not believe that Securities and Exchange Commission v. United States Realty & Improvement Co., 310 U. S. 434, compels an affirmance of the order below. Rather the circumstances presented in the present proceeding are essentially, in principle, the same as are set forth in In re Transvision, Inc., 217 Fed. 2d 243. Judge Medina, in the Transvision opinion, weighed both Securities Commission v. United States Realty Co., supra, and Mecca Temple, etc. v. Darrock, 142 Fed. 2d 869, but observed:

> "Nonetheless, the scope of the permissible inquiry into the propriety of proceeding under either chapter is not susceptible of ready definition solely in terms of the existence or non-existence of public stockholders."

Clearly herein there are presented but two classes of interests: (1) that of the stockholders; (2) that of unsecured creditors. It cannot be too strongly emphasized that neither the company itself nor its unsecured creditors seek a re-organization. A single stockholder and the Securities and Exchange Commission nevertheless intervene to thwart the plan of arrangement submitted by the corporation to its unsecured creditors which would enable those creditors to receive a full 100% payment of their claims.

What is to be effected by a plan of re-organization? What is there to re-organize?

An anomolous situation arises because if the debtor had moved in the first instance under Chapter 10, it is very doubtful whether in its petition it could have met the requirements of Section 530, Title 11 of Chapter 10. In that event it would seem that the provisions of Section 547 of Title 11, Chapter 10, would apply. That section provides that when a petition filed under Chapter 10 discloses that adequate relief could be obtained by the debtor under Chapter 11, an amendment to comply with the requirements of Chapter 11 could be made. See John Hancock Mut. Life Ins. Co. v. Casey, 141 Fed. 2d 104.

Acceptance of the plan of arrangement is on its face all that the company needs to carry on its affairs. The wage-earners who fall among the unsecured creditors, and who are eager to have prompt payment, certainly will suffer delay if proceedings are had under Chapter 10.

In the motion for leave to intervene made by the Securities and Exchange Commission it is alleged that "if the proposed arrangement is confirmed and the proceedings are not dismissed, the interests of investors in this proceeding will be improperly affected." But there is nothing in the record before this court which sustains that allegation.

The debtor has no funded debts by way of debentures or certificates of indebtedness of any kind—bonds, mortgages, notes or obligations of like character, sold, distributed or in the hands of the general public. So much appears in the affidavit of the president of the debtor. As I have intimated, the proposed plan of arrangement does not seek to modify in any form whatsoever the capital stock of the debtor.

The order under review, if the debtor desires to have the sanction of the Bankruptcy Act, leaves no alternative but to endeavor to comply with the requirements of Chapter 10. Failing that, it is faced with the necessity of endeavoring to settle with its creditors out of court. In

doing so if runs the hazard of committing an act of bankruptcy which might enable some creditors to file a petition in ordinary bankruptcy. So liquidation of the debtor would ensue. Chapter 10, as I have stated, is essentially designed to enable a debtor to work out a plan of reorganization. Historically its immediate predecessor was Chapter 77B of the Bankruptcy Act, and that in turn followed the old equity receivership, the outstanding characteristic of which was to seek a plan of reorganization of vested and conflicting interests.

It would seem to be sound common sense to leave the management of the business to the judgment of its officers and directors. There is not the slightest suggestion of the violation of any state law. Indeed if stockholders should determine that there has been bad management or misjudgment or fraud, ample relief is possible under the corporation laws of the State of New York, the domicile of the debtor.

For the foregoing reasons I feel impelled to dissent.

Judgment of Court of Appeals

United States Court of Appeals for the Second Circuit.

At a Stated Term of the United States Court of Appeals in and for the Second Circuit, held at the United States Courthouse in the City of New York, on the 14th day of April, one thousand nine hundred and fifty-five.

Present: Hon. Charles E. Clark, Chief Judge
Hon. Jerome N. Frank, Circuit Judge
Hon. Clarence G. Galston, District Judge

In the Matter of General Stores Corp., Debtor.

Appeal from the United States District Court for the Southern District of New York.

This cause came on to be heard on the transcript of record from the United States District Court for the Southern District of New York, and was argued by counsel.

On consideration whereof it is now hereby ordered, adjudged, and decreed that the order of said District Court be and it hereby is affirmed and action remanded in accordance with the opinion of this Court.

It is further ordered that the stay heretofore granted will remain in effect in accordance with the opinion of this Court until the District Court acts.

It is further ordered that a mandate issue to the said District Court in accordance with this decree.

(S) A. DANIEL FUSARO,
Clerk.

Filed April 14, 1953.

Stay of Proceedings Granted by the Court of Appeals Originally Pending Appeal and Now Pending Proceedings for Certiorari

A motion having been made herein by counsel for debtor-appellant for a stay pending appeal,

Upon consideration thereof, it is

Ordered that the effect of the order appealed from be and it hereby is stayed until determination of the appeal and in the meantime all parties to this proceeding are stayed from taking any steps to effectuate a plan of arrangement, including without limitation, its promulgation, filing, the soliciting of acceptances and its confirmation.

(S) A. DAVID FUSARO,
Clerk.

Filed April [illegible], 1953.

Stipulation and Order Staying Mandate

IT IS HEREBY STIPULATED, AGREED AND CONSENTED TO by and between the undersigned, the interested parties in the above entitled matter, that the issuance of the mandate of the Court of Appeals for the Second Circuit on its decision in the above entitled matter, made and entered on the 14th day of April, 1955, affirming the order of District Judge Edward J. Dimock dated February 4, 1955 and entered March 7, 1955, be stayed for thirty (30) days from the date of the entry of an order on this stipulation, pending the Debtor's application for certiorari to the Supreme Court of the United States from the aforesaid decision, and the said stay shall expire at the end of said thirty (30) days and the mandate issued forthwith at that time, unless within said thirty (30) days there is filed with the Clerk of the Court of Appeals for the Second Circuit, the certificate of the Clerk of the Supreme Court of the United States that the certiorari petition, record and briefs have been filed; whereupon, the said stay shall continue until the final disposition of the case by the Supreme Court of the United States; and in the meantime all parties to this proceeding are stayed from taking any steps to effectuate a plan of arrangement, including without limitation, its promulgation, filing, the soliciting of acceptances and its confirmation.

IT IS FURTHER STIPULATED AND AGREED that an order may be entered on this stipulation without further notice.

Dated: New York, New York, May 24, 1955.

OTTERBOURG, STEINDLER, HOUSTON & ROSEN,
Attorneys for Debtor.

REICH, PELLER, GUADAGNO & CAINE,
Attorneys for Appellee,
Max Shlensky.

WILLIAM H. TIMBERS,
Attorney for Appellee,
Securities & Exchange Commission.

BLUMBERG, SINGER, HEPPEN & BLUMENTHAL,
Attorneys for Creditors of
General Stores Corporation.

WEINSHENKER & KENNER,
Attorneys for Wage Claimants.

So ordered
May 25, 1955.

(s) HAROLD R. MEDINA,
U. S. C. J.

Statutes

Pertinent provisions of the Bankruptcy Act of 1898, as amended, Section 12(d) (U. S. C. Sec. 30(d); 30 Stat. 549) before its provisions were incorporated in Chapter XI of the Bankruptcy Act of 1934, as amended, provided as follows:

> SEC. 12. Compositions; when confirmed. . . .
>
> (d) The judge shall confirm a composition if satisfied that (1) it is for the best interests of the creditors; (2) the bankrupt has not been guilty of any of the acts or failed to perform any of the duties which would be a bar to his discharge; and (3) the offer and its acceptance are in good faith and have not been made or procured except as herein provided, or by any means, promises, or acts herein forbidden.

Pertinent provisions of Chapter X (Corporate Reorganizations) of the Bankruptcy Act of 1938, as amended, (The Chandler Act) (11 U. S. C. 501 et seq.; 52 Stat. 883):

Section 107 of the Bankruptcy Act (11 U. S. C. 507; 52 Stat. 884) provides:

> SEC. 107. Creditors affected by plan; determination:
>
> Creditors or stockholders or any class thereof, shall be deemed to be "affected" by a plan only if their or its interest shall be materially and adversely affected thereby. In the event of controversy the Court shall, after hearing upon notice, summarily determine whether any creditor or stockholder or class is so affected.

Section 130(7) of the Bankruptcy Act (11 U. S. C. 530(7); 52 Stat. 886) provides:

> SEC. 130. Contents:
>
> Every petition shall state . . . .
>
> (7) the specific facts showing the need for relief under this chapter and why adequate relief cannot be obtained under Chapter XI of this Act; . . .

Section 14 of the Bankruptcy Act (11 U. S. C. 541; 52 Stat. 887) provides:

> SEC. 541. Petition of debtor:
>
> Upon the filing of a petition by a debtor, the judge shall enter an order approving the petition, if satisfied that it complies with the requirements of this chapter and has been filed in good faith, or dismissing it if not so satisfied.

Section 146(2) of the Bankruptcy Act (11 U. S. C. 546(2); 52 Stat. 887) provides:

> SEC. 146. Good faith of petition:
>
> Without limiting the generality of the meaning of the term "good faith", a petition shall be deemed not to be filed in good faith if—
>
> (2) Adequate relief would be obtainable by a debtor's petition under the provisions of Chapter XI of this Act; . . .

Section 147 of the Bankruptcy Act (11 U. S. C. 547; 52 Stat. 888) provides:

> SEC. 147. Amendment of petition to comply with provisions governing arrangements:
>
> A petition filed under this chapter improperly because adequate relief can be obtained by the debtor under Chapter XI of this Act may, upon the application of the debtor, be amended to comply with the requirements of Chapter XI for the filing of a debtor's petition, and shall thereafter for the purposes of Chapter XI be deemed to have been originally filed thereunder.

Section 221(2) of the Bankruptcy Act (11 U. S. C. 621; 52 Stat. 897) provides:

> SEC. 221. Confirmation by Court:
>
> The judge shall confirm a plan if satisfied that—
>
> . . .
>
> (2) the plan is fair and equitable, and feasible;
>
> . . .

Pertinent provisions of Chapter XI (Arrangements) of the Bankruptcy Act (11 U. S. C. 701 et seq.; 52 Stat. 905, as amended).

Section 306(1) and (3) of the Bankruptcy Act (11 U. S. C. 706; 52 Stat. 906) provides:

> (1) "Arrangement" shall mean any plan of a debtor for the settlement, satisfaction or extension of the time of payment of his unsecured debts, upon any terms; * * *
>
> (3) "Debtor" shall mean a person who could become a bankrupt under Section 4 of this Act and who files a petition under this chapter; * * *

Section 308 of the Bankruptcy Act (11 U. S. C. 708; 52 Stat. 906) provides:

> SEC. 308. Creditors affected by arrangement; determination:
>
> A creditor shall be deemed to be "affected" by an arrangement only if his interest shall be materially and adversely affected thereby. In the event of controversy, the court shall after hearing upon notice summarily determine whether any creditor is so affected.

Section 322 of the Bankruptcy Act (11 U. S. C. 722; 52 Stat. 907) provides:

> SEC. 322. Original petition:
>
> If no bankruptcy proceeding is pending, a debtor may file an original petition under this chapter with the court which would have jurisdiction of a petition for his adjudication.

Section 328, as added to the Bankruptcy Act in 1952 (11 U. S. C. 728; 66 Stat. 432) provides:

> SEC. 328. Dismissal, proceedings; amended petition:
>
> The judge may, upon application of the Securities and Exchange Commission or any party in interest,

and upon such notice to the debtor, to the Securities and Exchange Commission, and to such other persons as the judge may direct, if he finds that the proceedings should have been brought under Chapter X of this Act, enter an order dismissing the proceedings under this chapter, unless, within such time as the judge shall fix, the petition be amended to comply with the requirement of Chapter X of this Act for the filing of a debtor's petition or a creditors' petition under such chapter, be filed. Upon the filing of such amended petition, or of such creditors' petition, and the payment of such additional fees as may be required to comply with Section 132 of this Act, such amended petition or creditors' petition shall thereafter, for all purposes of chapter X of this Act, be deemed to have been originally filed under such chapter.

Section 366 as amended in 1952 (11 U. S. C. 766; 66 Stat. 43) provides in pertinent part:

SEC. 366. Requisites for confirmation:

The court shall confirm an arrangement if satisfied that—

* * *

(2) it is for the best interests of the creditors and is feasible;

* * *

Confirmation of an arrangement shall not be refused solely because the interest of a debtor, or if the debtor is a corporation, the interests of its stockholders or members will be preserved under the arrangement.